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In the Supreme Court of the United States

OCTOBER TERM, 1931.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

COMMONWEALTH IMPROVEMENT COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

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v.

COMMONWEALTH IMPROVEMENT COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

PETITION

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit entered in the above cause on March 17, 1932, reversing the decision of the United States Board of Tax Appeals.

STATEMENT

The findings of fact by the Board of Tax Appeals (R. 16–20), so far as relevant, are as follows:

In 1912 P. A. B. Widener transferred all his
curities, except those of Pennsylvania corp
tions,[1] to the taxpayer, a Pennsylvania corporat
in return for which the taxpayer issued to Wide
$25,000,000 worth of its stocks and bonds which
stituted all of the securities issued by it. Wide
died in 1915, and as a result of the transfer of
securities to the taxpayer, no death taxes were p
to any States except Pennsylvania. (R. 16–
Widener's executors and trustees constituted
of the taxpayer's three directors, the third was
counsel, later counsel for his estate. (R. 18.)
trustees received salaries as officers of the taxpa
but no commissions as trustees. (R. 19.) The
fice expenses of the estate were paid by the t
payer. (R. 19.)

Among the securities transferred by Widene
the taxpayer in 1912 were 225,000 shares of Briti
American Tobacco Company stock, the value
which on March 1, 1913, was $5,315,625, or $23.
per share. In 1919 taxpayer acquired the righ
subscribe for one new share of this stock for ev
three shares it held at a price of $4.3525 per sh
and exercised the right by purchasing 75,000 sha
for $326,437.50. (R. 20.)

In 1920 the taxpayer transferred to the Wide
estate 225,000 shares of this stock of a market va
of $23.50 per share or a total of $5,287,500, in ret
for which it received certain stocks and bonds
credits to its account. (R. 20.) In its return

[1] And one share of United States Steel Corporation st

1920, the taxpayer showed a loss by applying the selling price of $5,287,500 against $5,315,625, representing the March 1, 1913, value. (R. 10, 21.)

The Commissioner made the following adjustment in the March 1, 1913, value. He added the March 1, 1913, value of the original 225,000 shares in the sum of $5,315,625 to the cost of the acquisition of the 75,000 shares in the sum of $326,437.50, making a total of $5,642,062.50 for 300,000 shares. He divided $5,642,062.50 by 300,000, which gives a price of $18.806875 for 1 share; and multiplied the price of one share by 225,000, resulting in an adjusted value in the sum of $4,231,566.88 for 225,000 shares. (R. 10–12.)

This resulted in a profit of $1,055,953.12 instead of the loss claimed by the taxpayer, and the determination by the Commissioner of a deficiency in tax of $294,388.42. (R. 10–12.) The taxpayer filed a petition for review of the Commissioner's determination with the Board of Tax Appeals (R. 3), which upheld the Commissioner's action. (20 B. T. A. 1189.)

The taxpayer appealed to the Circuit Court of Appeals for the Third Circuit (R. 26), which reversed the decision of the Board of Tax Appeals, holding that the estate owned the taxpayer and that under the circumstances the profit determined by the Commissioner was illusory and nonexistent. Holding thus that the separate identities of the corporation and the estate should be disregarded, the court below found it unnecessary to

pass expressly upon the question of the validity of Article 39, as amended, of Treasury Regulations 45, which was also presented to it.

SPECIFICATION OF ERRORS TO BE URGED

1. The Circuit Court of Appeals erred in deciding that the taxpayer, a corporation, and the Widener estate, which owned all the stock of the corporation, were in substance identical, so that a transaction between them could not result in gain or loss under Section 202 of the Revenue Act of 1918.

2. The Circuit Court of Appeals erred in not deciding that there was a deficiency in the amount of $294,388.42 in the respondent's income and profits taxes for the year 1920.

3. The Circuit Court of Appeals erred in reversing the judgment of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

1. The decision of the Circuit Court of Appeals in holding that where an estate owns all the stock of a corporation, the separate entity of the corporation should be disregarded for Federal tax purposes, is in conflict in principle with the following decisions of the Circuit Court of Appeals for the Second Circuit, the Court of Appeals of the District of Columbia, and the Circuit Court of Appeals for the Fifth Circuit: *Nixon* v. *Lucas,* 42 F. (2d) 833 (C. C. A. 2d); *Wagner* v. *Lucas,* 38 F. (2d) 391 (App. D. C.); *Goldberg* v. *Commissioner,* 36 F. (2d) 551 (App. D. C.); *Planters' Cotton Oil Co., Inc.,* v. *Hopkins,* 53 F. (3d) 285 (C. C.

A. 5th), affirmed as No. 672, October Term, 1931, on May 16, 1932.

2. Because of the number of corporations all of whose stock is owned by an individual or an estate or a partnership or by some other taxable entity other than a corporation, the question as to whether or not transactions between two such entities result in taxable gain or deductible loss frequently arises in various forms under all the Revenue Acts. This question is of general importance in administering the income tax laws. The court below regarded the decisions of this Court in *Southern Pacific Company* v. *Lowe*, 247 U. S. 330, and *Gulf Oil Corporation* v. *Lewellyn*, 248 U. S. 71, as laying down principles of general application in tax cases. The court in *Nixon* v. *Lucas, supra*, concluded that the *Southern Pacific Co.* case had a more limited application. It is of importance to the Government and to taxpayers generally that the question presented in this case should be settled by this Court so that existing confusion may be removed.

Wherefore, it is respectfully submitted that the petition should be granted.

THOMAS D. THACHER,
Solicitor General.

MAY, 1932.

BRIEF IN SUPPORT OF THE PETITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 16–25) is reported in 20 B. T. A. 1189. The opinion of the Circuit Court of Appeals is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals for the Third Circuit was entered March 17, 1932. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether in this case the corporation and the estate, which owns all the stock of the corporation, are separate entities, so that a transaction between them resulted in gain under Section 202 of the Revenue Act of 1918.

STATUTE INVOLVED

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1060, 1065, 1077:

> SEC. 202. (a) That for the purpose of ascertaining the gain derived or loss sustained from the sale or other disposition of property, real, personal, or mixed, the basis shall be—

(1) In the case of property acquired before March 1, 1913, the fair market price or value of such property as of that date; * * *

* * * * *

(b) When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any; * * *.

SEC. 213. That for the purposes of this title * * * the term "gross income"—

(a) Includes gains, profits, and income derived from * * * dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

SEC. 233. (a) That in the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in section 213, * * *.

STATEMENT

A statement of the facts and the errors to be relied upon will be found in the petition.

ARGUMENT

In concluding that the separate entities of the corporation and the estate which controlled it

should be disregarded in this case, the court below relied chiefly upon two decisions of this Court, *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, and *Gulf Oil Corp.* v. *Lewellyn,* 248 U. S. 71, which it apparently considered as laying down a principle of universal application in tax cases. In those cases, this Court decided that where one corporation owned all the stock of another and controlled its management, and dividends were declared by the subsidiary out of earnings that accrued before the adoption of the Sixteenth Amendment, the distributions were capital and not income. In the *Southern Pacific Co.* case, this Court said (p. 338):

> The case turns upon its very peculiar facts, and is distinguishable from others in which the question of the identity of a controlling stockholder with his corporation has been raised.

In *Nixon* v. *Lucas,* 42 F. (2d) 833 (C. C. A. 2d), which is one of the cases now relied upon as in conflict with the decision of the court below, the court declined to regard the *Southern Pacific Co.* case as laying down a general rule of universal application in tax cases and treated it as depending upon its peculiar facts.

We believe that the decisions of this Court relied on by the court below do not govern this case. In the instant case, the gain in question accrued long after the adoption of the Sixteenth Amendment, and two kinds of taxable entities, carrying different rates of taxation—an estate and a corporation—

were involved. Congress recognized the principle of the substantial identity of two corporations, one of which owned all the stock of the other, by enacting Section 240 of the Revenue Act of 1918 and successive provisions in later Acts, which permitted two or more corporations to file a consolidated return under prescribed circumstances. But Congress gave no corresponding privilege to an estate or an individual which owned all the stock of a corporation. The Court of Appeals of the District of Columbia, the Circuit Court of Appeals for the Second Circuit, and the Circuit Court of Appeals for the Fifth Circuit have decided that under circumstances analogous to those in the instant case, the corporate entity should not be disregarded.

In *Goldberg* v. *Commissioner,* 36 F. (2d) 551 (App. D. C.), wherein a taxpayer sought to identify himself with the corporation of which he was the sole stockholder, the court said (p. 552):

> While it is true that this was a one-man corporation, of which appellant owned the entire stock, it nevertheless was a separate and distinct corporate entity, and the business transacted in the name of the corporation was not the business of appellant but the business of the corporation, and as such entirely separate and distinct from the private affairs of appellant.

In *Wagner* v. *Lucas,* 38 F. (2d) 391 (App. D. C.), the court refused to recognize the identity of an individual and a corporation of which he owned practically all the stock, and said (p. 392):

> It is true that the court, in tax cases as well as in other matters, where a corporation is a one-man corporation, may look through the corporate entity, and, where necessary to accomplish the ends of justice or prevent fraud, attach responsibility to the individual. We think, however, that there is no occasion for the application of this rule in the present case. * * * The mere fact that he owned substantially all of the stock in the Washington corporation would not deprive it of functioning as a corporate entity. It possessed all the powers and liabilities of a private corporation, and must be treated as such.

In *Nixon* v. *Lucas,* 42 F. (2d) 833 (C. C. A. 2d), three partners, who were engaged in selling lumber, owned all of the stock in a company from which they purchased lumber, and asserted the right to deduct in their individual returns a loss suffered by the company. The Court said (p. 834):

> In the case at bar the partners chose, for some reason not disclosed, to deal with the company as a legal person, which they could do if they wished. Their agreements created contracts with the same obligations as though the company had been an individual. There were no attendant circumstances which show that they were not so intended, as in the case of contracts made as a jest, or only to serve as a blind. The fact that the partners could at any time have taken over the assets and dealt directly with their customers, is not a reason for looking behind the pattern

so devised and used. Whatever they might have done, they did what they did.

In *Planters' Cotton Oil Co., Inc.*, v. *Hopkins*, 53 F. (2d) 825 (C. C. A. 5th), certiorari granted March 21, 1932, affirmed as No. 672, October Term, 1931, on May 16, 1932, the Circuit Court of Appeals declined to regard one who owned substantially all the stock in several corporations as so identified with them that "net losses" sustained by two of the companies could be treated as if they had been the "net losses" of the stockholder or of other corporations which he controlled.

It may be pointed out that the taxpayer held itself out as a separate entity when it claimed a loss on the identical transaction which the Commissioner determined resulted in a gain. (R. 10, 21.) Moreover, during Widener's life and after his death, taxpayer paid taxes at the rates governing corporations instead of individuals or estates, and the transfer by Widener of his non-Pennsylvania stocks to the taxpayer resulted in the avoidance of estate taxes outside of Pennsylvania. (R. 18.) Having chosen to create a separate entity and having received the benefits inherent in enterprises conducted in corporate form, the management of the taxpayer should not now be allowed to deny its separate character merely because it would be to its present advantage to do so.

The decision of the court below disregarding the corporate entity rendered it unnecessary to decide the question of ascertaining the basis for determin-

ing gain or loss where a stockholder exercises the right to subscribe to new stock of substantially the same character, and the court did not expressly pass upon the question. However, the court said in its opinion:

> At the time of the exchange, the regulations of the Treasury Department prescribed the value of March 1, 1913, of stock acquired prior to that time as the basis for determining profit or loss. Article 39, Regulations 45. But the regulations were amended in 1922 by T. D. 3206, and accordingly the Commissioner ruled that the value of the stock must be reduced proportionally by the quotient basis because the taxpayer had acquired 75,000 additional shares in 1919 by virtue of its stock rights. On paper, then, the Commissioner determined that the taxpayer had made a large profit by the exchange.

The occasion for the change in the regulations was the decision of this Court in *Miles* v. *Safe Deposit Co.*, 259 U. S. 247. The Commissioner amended the regulations so that they would conform to the principles laid down by this Court. If the court below intended to question the validity of the regulations as amended, the decision is in conflict with that of the Court of Appeals of the District of Columbia in *Ayer* v. *Blair*, 25 F. (2d) 534, which held under similar circumstances that the cost of the old and of the new stock must be averaged in order to determine the basis upon which gain or loss should be determined.

CONCLUSION

The decision of the court below appears to be wrong, and it is in conflict in principle with the decisions of other Circuit Courts of Appeals. Moreover, the question involved is of general importance in the administration of the tax laws, and it is desirable that it should be authoritatively settled by a decision of this Court to eliminate existing conflicts of decisions and so that the apparent confusion as to the proper application of its decision in the *Southern Pacific Co.* case may be removed. Therefore, it is respectfully submitted that the petition for certiorari in this case should be granted.

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MAY, 1932.

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